Public Governance Institutions and Their Impact on Delocalization of Labor Intensive Industries: The Case of Estonia

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Agenda

• Estonia: general information;
• Definitions and problems;
• The EU, national and local level issues;
• National level governance: labour market examples from Estonia
• Sectors: electronics and garment industries;
• Some conclusions.
## The Baltic States (1)

### Indicators

<table>
<thead>
<tr>
<th></th>
<th>Estonia,</th>
<th>Latvia,</th>
<th>Lithuania,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population, 1.1.2004 (mln)</td>
<td>1.351 Tallinn, ca 0.400</td>
<td>2.319 Riga, ca 0.740</td>
<td>3.446 Vilnius, ca 0.550</td>
</tr>
<tr>
<td>Area, km²</td>
<td>45227</td>
<td>64589</td>
<td>65300</td>
</tr>
<tr>
<td>Density, population per km²</td>
<td>30</td>
<td>36</td>
<td>53</td>
</tr>
<tr>
<td>GDP, EUR mln, 2004</td>
<td>8042</td>
<td>9802</td>
<td>16142</td>
</tr>
<tr>
<td>GDP per capita, EUR, 2004, in current prices / PPP</td>
<td>6600/11200</td>
<td>4800/9700</td>
<td>5200/10700</td>
</tr>
<tr>
<td>Currency, 2004</td>
<td>EUR 1=15.6466 kroons (EEK)</td>
<td>EUR 1= 0.6708 lats (LVL)</td>
<td>EUR 1=3.4528 litas (LTL)</td>
</tr>
</tbody>
</table>
## The Baltic States (2)

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population by ethnicity</td>
<td>Estonians 68%</td>
<td>Latvians 59%</td>
<td>Lithuanians 84%</td>
</tr>
<tr>
<td></td>
<td>Russians 26%</td>
<td>Russians 29%</td>
<td>Russians 6%</td>
</tr>
<tr>
<td></td>
<td>Others 6%</td>
<td>Others 12%</td>
<td>Others 10%</td>
</tr>
<tr>
<td>Population in large cities, 2004</td>
<td>Tallinn 396</td>
<td>Riga 739</td>
<td>Vilnius 553</td>
</tr>
<tr>
<td>(thousands)</td>
<td>Tartu 101</td>
<td>Daugavpils 113</td>
<td>Kaunas 369</td>
</tr>
<tr>
<td></td>
<td>Narva 68</td>
<td>Liepaja 87</td>
<td>Klaipeda 190</td>
</tr>
<tr>
<td>Gini index, 2004</td>
<td>0.36</td>
<td>0.36</td>
<td>0.32</td>
</tr>
</tbody>
</table>
GDP structure in the Baltic States and EMU-s, % (source: WB)

<table>
<thead>
<tr>
<th></th>
<th>Estonia</th>
<th></th>
<th>Latvia</th>
<th></th>
<th>Lithuania</th>
<th></th>
<th>EMU 02</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>90</td>
<td>95</td>
<td>03</td>
<td>90</td>
<td>95</td>
<td>03</td>
<td>90</td>
</tr>
<tr>
<td>Agriculture</td>
<td>16</td>
<td>9</td>
<td>5</td>
<td>22</td>
<td>10</td>
<td>5</td>
<td>27</td>
</tr>
<tr>
<td>Industry</td>
<td>50</td>
<td>29</td>
<td>30</td>
<td>46</td>
<td>33</td>
<td>24</td>
<td>31</td>
</tr>
<tr>
<td>Services</td>
<td>34</td>
<td>62</td>
<td>65</td>
<td>32</td>
<td>57</td>
<td>71</td>
<td>42</td>
</tr>
</tbody>
</table>
## GDP per capita in comparison with the EU-15 average, PPP, %

<table>
<thead>
<tr>
<th>State</th>
<th>GDP per capita, from EU-15 average, %</th>
<th>Average annual growth rate of GDP, %</th>
<th>Decrease of difference from EU-15, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovenia</td>
<td>61.2</td>
<td>66.4</td>
<td>71.5</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>62.2</td>
<td>59.6</td>
<td>65.3</td>
</tr>
<tr>
<td>Hungary</td>
<td>44.9</td>
<td>48.8</td>
<td>56.6</td>
</tr>
<tr>
<td>Poland</td>
<td>34.4</td>
<td>41.7</td>
<td>44.2</td>
</tr>
<tr>
<td>Estonia</td>
<td>31.2</td>
<td>37.6</td>
<td>47.6</td>
</tr>
<tr>
<td>Latvia</td>
<td>26.2</td>
<td>31.5</td>
<td>40.8</td>
</tr>
<tr>
<td>Lithuania</td>
<td>31.9</td>
<td>35.8</td>
<td>45.2</td>
</tr>
</tbody>
</table>
Definitions

• Governance is generally understood as a broad process affecting the collective decision-making roles and procedures, management and authority relationships of social and economic agents involving multiple jurisdictions and domains;
• Delocalization is the transfer of production activities from one region to another or from one country to another country;
• Outward and inward delocalization;
• Delocalization through FDI and/or outsourcing.
Research question

• The transfer, first of all by multinational companies, of production activities from one country to another has become an important issue in public governance;
• Should manufacturers be encouraged not to delocalize?;
• Should there be massive investment in research and development in an effort to maintain a technological edge and what are conditions for that?;
• Is it possible that delocalization creates massive unemployment and social problems?
• In general, how much delocalization is governable and on what level?
Public governance (1)

• Governance cannot be isolated from political responsibility in all areas in which delegated authority makes decisions;

• Public governance issues are treated at different levels, the EU regulations frame, national governments possible approaches, local (regional) government level.
Governance on EU level (1)

- Global level is realised through international organisations (UN, WTO, ILO, WB, IMF, OECD etc.);
- The EU level: important are labor relations;
- The EU level: innovation policy (and Lisbon agenda), industrial policy, foreign trade strategy (toward Asian countries and in the WTO context) are important but depend also on other players, there are single issues where the EU decisions are crucial for delocalisation;
- Tax policy solutions and subsidies on the EU level have less impact on electronics and garment industries.
Governance on EU level (2)

- The principle of subsidiarity, which foresees that the decisions should be taken at the national level (or local) level, unless there is a strong and specific case for Community action;
- Probable issues: social dumping, race to the bottom, harmful tax competition.
Governance on national level (1)

- Labor market policy (active, passive) and regulations regarding hiring, firing, part-time jobs, solving disputes.
- Migration policy started to be very crucial during couple of years: labor force is leaving from labor intensive industries abroad, could be substituted by part/full time labor from third countries;
- Quotas for migrants, permanent working permissions;
- Trade unions: in Estonian case two main unions with limited coverage of employees (14% of labor force), some impact in transportation, public services but quite limited in electronics and garment industries;
National level governance: labor market (1)

- The overall labor market policy on government level is a duty of the Ministry of Social Affairs;
- The main institutions dealing with conflict resolution are the industrial dispute commissions, the public conciliator as well as local conciliators, and courts;
- The relations are mainly regulated through minimum standards set at the state level (minimum wage, unemployment benefits, the minimum subsistence level);
National level governance: labor market (2)

• In some areas problems are solved through social dialogue on national level and through individual contracts or enterprise level contracts;
• The social dialog is realized through tripartite negotiations, where the parts are the government, representatives of employers and employees.
National level governance: labor market (3)

• The possibility of labor migration out of country increases bargaining power of trade unions;
• In Estonia, examples of possible effects have been demonstrated by an earlier study: in health care sector unions have gained additional strength by the possibility for medical personal to move abroad; in the textile sector the unions have lower bargaining power due to the possible relocation of industry out of country;
• Quotas for migrants, permanent working permissions;
• Example: pooling together Estonian and Finnish labor market.
National level governance: labor market (4)
National level governance: tax policy and investments

- Tax policy decisions on national government level are important, first of all for garment industry, postponing probably delocalisation decisions: important taxes are corporate and personal income tax levels, social tax and financing of social security system;
- FDI, foreign trade, more dependent on the EU policy;
- Innovation: public part is dominating in financing of the R&D expenditures, small part for companies;
## Research & Development expenditures, % of GDP

<table>
<thead>
<tr>
<th>State</th>
<th>R&amp;D expenditure as % of GDP</th>
<th>Proportion of R&amp;D expenditure, %, 2003</th>
<th>Annual average growth rate, %, real terms, 2001-2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2001</td>
<td>2004</td>
<td>Government</td>
</tr>
<tr>
<td>EU-25</td>
<td>1.93</td>
<td>1.90</td>
<td>46</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.73</td>
<td>0.91</td>
<td>67</td>
</tr>
<tr>
<td>Latvia</td>
<td>0.41</td>
<td>0.42</td>
<td>67</td>
</tr>
<tr>
<td>Lithuania</td>
<td>0.68</td>
<td>0.76</td>
<td>83</td>
</tr>
<tr>
<td>Finland</td>
<td>3.38</td>
<td>3.51</td>
<td>30</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.27</td>
<td>3.74</td>
<td>35</td>
</tr>
<tr>
<td>Germany</td>
<td>2.46</td>
<td>2.49</td>
<td>33</td>
</tr>
<tr>
<td>USA</td>
<td>2.71</td>
<td></td>
<td>37</td>
</tr>
</tbody>
</table>
National level governance: subcontracting and position in value chain

• Subcontracting and off-shoring: critical moments are influence strongly by national level macroeconomic conditions (foreign exchange rate, price and wage level);

• Value chain issues: related to innovation and product development of companies, very hard to have direct impact with public governance;
National level governance: clusters

- Clusters: some countries have special policies;
- Estonia is too small to have its own clusters, belongs in some areas to Scandinavian clusters (IT, pulp and paper, wood processing, increasingly food);
- Question about a position in the value chain, strong connection to the level and recognition of basic research;
Local level governance

- General conditions for business activities (transactions with real estate);
- Basically transactions are free, but there are some transactions where local government has possibility to be the first buyer: if purpose of land in planning scheme should be changed (from social use to production or housing etc:);
- Labour market issues: business incubators, development programs;
- Communication between public, public administration and business community.
Sectors (1)

• Supportive measures applied as a correction to specific market failures instead of generic support for one or another sector;
• Rather than providing investment incentives for some sector, government programs subsidized:
  - bilingual training;
  - feasibility reports;
  - infrastructure investment;
  - adaptation of foreign technology to local conditions;
  - risk and venture capital.
Sectors (2)

• Public procurement has been important for software and hardware companies;
• Industrial associations has been functioning as a lobby group, especially regarding policies&programs of the Ministry of Economic Affairs and Communications;
• Military orders for some software companies, policies regarding participation in international events are influential.
Sectors (3)

- Major role in public policy is played by standardization. Despite not being directly governmental activity, standards remain an important tool in trade practice.
- Bigger countries with dominating firms are in favour of common standards;
- Weaker and smaller counterparts try to protect themselves by using different standards;
- Example: software companies creating accounting programs and operating them.
Electronics (1)

- Electronics is a specific industry employing a relatively big number of highly educated engineers, medium educated workers and people with basic skills;
- Proportion of those groups is very dependent on position of a particular company in a value chain;
- Trade union representation is relatively low in that sector;
- Very closely connected to higher education and research institutions, target for government funding of research and development activities;
- Employer’s of this industry are a very strong lobby group on national level due to prestige, future perspectives of the industry.
Electronics (2)

- Electronics industry has been influenced by policies in the field of technology, defense, education and trade;
- Estonian electronic industry is part of the larger Nordic electronic industry cluster;
- Estonia’s electronic industry companies are locating in low part of the value chain, very sensitive to wage pressures;
- Delocalization through the FDI and subcontracting would move out big proportion of production from Estonia;
- The quality of innovation system will be very critical factor for future development in this industry.
Garment industry (1)

- Estonian wage level is critical for production;
- Companies are changing from producers to wholesale and retail sale providers (*Baltika* is a successful example);
- In the value chain context, that means moving upward;
- The CIS is the target area;
- Some adjustment possibilities due to regional differences in production costs;
- Delocalization of production in the form of outsourcing to the CIS and China is another option.
Garment industry (2)

- Very limited trade union representation;
- The bargaining power of trade unions is weak due to delocalization possibilities of production;
- Absorption capacity of other (mass) production sectors like electronics is a critical issue.
Garment industry (3)

• The companies have been organized into the Estonian Clothing and Textile Association (ECTA) founded in 1993.
• The main goal of the ECTA is to promote development of the clothing and textile industry and represent and protect common interests.
• The ECTA is a member of the European Clothing and Textile Association (EURATEX).
• Information, consultations and some possibilities to have impact on the EU level policy decisions concerning, for example, textile imports from third countries have been the main advantage of being part of international community related to this industry.
Crosstabs: How employment conditions (health standards, labour costs, working hours) influenced your company’s decision to delocalise? (V 254)

- **Software**: positively (4.3%-33.3%, highest UK); negatively (2-8%); no influence 56.5%-94.1%;
- **Electronics**: positively (UK 28.6%, others 6.4%-9.5%); no influence (UK 52.4%, others 70.5%-82.6%), negatively 0-14%, highest UK)
- **Garment industry**: positively (Estonia 8.3%, Bulgaria 21.3%, Poland 30.0%, UK 36.4%, Greece 71.0%); negatively: Estonia 31.7%, no influence quite a lot;
Crosstabs: Has the firm received any outside assistance from any support programme (including local, national or EU programmes during the last 5 years? (V 255)

• **Software**: yes, very high for UK, 66.7%, others between 13.7%-40.0%;
• **Electronics**: yes, high UK, 66.7%, Greece 52.4%, low, Bulgaria, 4.5%, Estonia, 26.9% Poland 34.8%;
• **Garment industry**: yes, highest UK, 54.5%, others around 10%, lowest Bulgaria, 1.6%;
Crosstabs: Financed by (V 257)

- **Bulgaria**: EU in software (9), electronics (3), footwear (3), CG 4, RG 1, others 2;
- **Estonia**: EU in electronics (6), CG in electronics (11) total: EU 12, CG 17, RG 5, quasi gov org (16);
- **Greece**: EU in electronics (6) CG (5), more projects by CG (17), EU (13), RG (1);
- **Poland**: EU in software 11, total EU 24, CG 14, RG 5, Qgov 5;
- **UK**: RG in electronics (9), software (6), CG respectively (9) and (6); Total: RG 19, CG 13, EU (2), Quasigov (2)
Some conclusions (1)

• The critical areas where economic interests and public policies meet are the labor market regulations, the FDI related problems, innovation, industrial policy;
• One important aspect is related to the overlapping jurisdiction and regulation issues in the field of social protection and labour market on the EU level and division of responsibilities between the EU institutions and national governments;
• The relationship between the MNE-s and different level governments is another important issue in internationalization of economic activities, new market economies have very often problems here.
Some conclusions (2)

• Estonia has been a target for delocalization of production. Only recently outward delocalization emerged as an issue;
• Estonia and most of other East and Central European countries offer permissive institutional environment which is regulated through minimum standards set at the state level;
• Integration with respective Scandinavian clusters has been important for Estonian electronics and garment industries;
• The critical aspects for future development are connected to fate of those clusters and their adjustment strategies. Also position of Estonia’s companies in value chain is a very critical factor.